

Office of Chief Counsel  
Internal Revenue Service

**memorandum**

TL-N-2512-99

JForsberg

date: November 24, 1999

to: Wanda Gorell  
Technical Support Branch, ESB  
North Central District

from: District Counsel, North Central District

subject: [REDACTED]  
[REDACTED] Interest Claim

This is in response to your request for advice as to the dates from which interest accrues on the deficiencies assessed for the [REDACTED]'s taxable years [REDACTED], [REDACTED], [REDACTED], and [REDACTED].

Issue

Under the facts set forth below, from what dates does interest accrue on the deficiencies assessed for the [REDACTED]'s taxable years [REDACTED], [REDACTED], [REDACTED], and [REDACTED]?

Conclusion

Where a taxpayer has reported an overpayment on its return for year 1 and has elected to have the overpayment applied to its estimated taxes for year 2, interest does not accrue on the deficiency until, and only to the extent, the overpayment has been reduced below the amount of the deficiency by having been applied to year 2's estimated taxes, or, to the extent the overpayment is not fully used to satisfy year 2 estimated taxes, until the original due date of the year 2 return.

Facts

[REDACTED] (the "taxpayer") has a taxable year ending December 31. Pursuant to extension, the taxpayer's [REDACTED] return was timely filed on or about [REDACTED]. The [REDACTED] return showed a tax liability of \$ [REDACTED], and an overpayment of \$ [REDACTED] which the taxpayer elected to apply to its [REDACTED] estimated tax liability. The taxpayer did not designate the quarterly estimated tax payment to which the overpayment was to be applied. Per the transcript of account, it appears that the

overpayment was applied to the [REDACTED] tax liability as of [REDACTED]. (It is unclear why the overpayment was applied as of [REDACTED] under the revenue ruling then in effect (Rev. Rul. 83-112, 1983-2 C.B. 247) the overpayment should have been applied as of the actual filing date of the [REDACTED] return.)

The taxpayer made the following estimated tax payments for [REDACTED]:

| <u>Installment Period</u> | <u>Estimated Tax Due<sup>1</sup></u> | <u>Estimated Tax Payment</u> | <u>Overpayment/ (Underpayment)</u> |
|---------------------------|--------------------------------------|------------------------------|------------------------------------|
| [REDACTED]                | \$ [REDACTED]                        | \$ [REDACTED]                | \$ [REDACTED]                      |
| [REDACTED]                | [REDACTED]                           | [REDACTED]                   | [REDACTED]                         |
| [REDACTED]                | [REDACTED]                           | [REDACTED]                   | [REDACTED]                         |
| [REDACTED]                | [REDACTED]                           | [REDACTED]                   | [REDACTED]                         |
|                           | \$ [REDACTED]                        | \$ [REDACTED]                | \$ [REDACTED]                      |

Pursuant to extension, the taxpayer's [REDACTED] return was timely filed on or about [REDACTED].

Pursuant to extension, the taxpayer's [REDACTED] return was timely filed on or about [REDACTED]. The [REDACTED] return showed a tax liability of \$ [REDACTED], and an overpayment of \$ [REDACTED], which the taxpayer elected to apply to its [REDACTED] estimated tax liability. The taxpayer did not designate the quarterly estimated tax payment to which the overpayment was to be applied and, accordingly, the overpayment was applied to the [REDACTED] tax liability as of [REDACTED].

The taxpayer made the following estimated tax payments for [REDACTED]:

<sup>1</sup> The quarterly estimated tax payments due are per the fax dated [REDACTED], from the taxpayer's representative [REDACTED]. We have not verified the correctness of the estimated tax computation.

| <u>Installment Period</u> | <u>Estimated Tax Due<sup>2</sup></u> | <u>Estimated Tax Payment</u> | <u>Overpayment/ (Underpayment)</u> |
|---------------------------|--------------------------------------|------------------------------|------------------------------------|
| [REDACTED]                | \$ [REDACTED]                        | \$ [REDACTED]                | \$ [REDACTED]                      |
| [REDACTED]                | [REDACTED]                           | [REDACTED]                   | [REDACTED]                         |
| [REDACTED]                | [REDACTED]                           | [REDACTED]                   | ( [REDACTED] )                     |
| [REDACTED]                | [REDACTED]                           | [REDACTED]                   | ( [REDACTED] )                     |
|                           | <u>\$ [REDACTED]</u>                 | <u>\$ [REDACTED]</u>         | <u>\$ [REDACTED]</u>               |

Pursuant to extension, the taxpayer's [REDACTED] return was timely filed on or about [REDACTED]. The [REDACTED] return showed a tax liability of \$ [REDACTED], and an overpayment of \$ [REDACTED], which the taxpayer elected to apply to its [REDACTED] estimated tax liability. The taxpayer did not designate the quarterly estimated tax payment to which the overpayment was to be applied and, accordingly, the overpayment was applied to the [REDACTED] tax liability as of [REDACTED].

The taxpayer made the following estimated tax payments for [REDACTED]:

| <u>Installment Period</u> | <u>Estimated Tax Due<sup>3</sup></u> | <u>Estimated Tax Payment</u> | <u>Overpayment/ (Underpayment)</u> |
|---------------------------|--------------------------------------|------------------------------|------------------------------------|
| [REDACTED]                | \$ [REDACTED]                        | \$ [REDACTED]                | \$ [REDACTED]                      |
| [REDACTED]                | [REDACTED]                           | [REDACTED]                   | [REDACTED]                         |
| [REDACTED]                | [REDACTED]                           | [REDACTED]                   | [REDACTED]                         |
| [REDACTED]                | [REDACTED]                           | [REDACTED]                   | ( [REDACTED] )                     |
|                           | <u>\$ [REDACTED]</u>                 | <u>\$ [REDACTED]</u>         | <u>\$ [REDACTED]</u>               |

<sup>2</sup> The quarterly estimated tax payments due are per the fax dated [REDACTED], from the taxpayer's representative [REDACTED]. We have not verified the correctness of the estimated tax computation.

<sup>3</sup> The quarterly estimated tax payments due are per the fax dated [REDACTED], from the taxpayer's representative [REDACTED]. We have not verified the correctness of the estimated tax computation.

Pursuant to extension, the taxpayer's [REDACTED] return was timely filed on or about [REDACTED]. The [REDACTED] return showed a tax liability of \$ [REDACTED], and an overpayment of \$ [REDACTED], which the taxpayer elected to apply to its [REDACTED] estimated tax liability. The taxpayer did not designate the quarterly estimated tax payment to which the overpayment was to be applied. Accordingly, the overpayment was applied to the first quarterly estimated tax payment for [REDACTED] pursuant to Rev. Ruling 88-98, 1988-2 C.B. 356.

The taxpayer made the following estimated tax payments for [REDACTED]:

| <u>Installment Period</u> | <u>Estimated Tax Due<sup>4</sup></u> | <u>Estimated Tax Payment</u> | <u>Overpayment/ (Underpayment)</u> |
|---------------------------|--------------------------------------|------------------------------|------------------------------------|
| [REDACTED]                | \$ [REDACTED]                        | \$ [REDACTED]                | \$ [REDACTED]                      |
| [REDACTED]                | [REDACTED]                           | [REDACTED]                   | [REDACTED]                         |
| [REDACTED]                | [REDACTED]                           | [REDACTED]                   | ( [REDACTED] )                     |
| [REDACTED]                | [REDACTED]                           | [REDACTED]                   | [REDACTED]                         |
|                           | <u>\$ [REDACTED]</u>                 | <u>\$ [REDACTED]</u>         | <u>\$ ( [REDACTED] )</u>           |

Subsequently additional aggregate deficiencies (net of abate-ments) were assessed for the years [REDACTED], [REDACTED], and [REDACTED] in the amounts of \$ [REDACTED], \$ [REDACTED], \$ [REDACTED], and \$ [REDACTED], respectively.

#### Discussion

In May Department Stores Co. v. United States, 36 Fed. Cl. 680 (1996), 1996-2 U.S.T.C. ¶ 50,596, acq. 1997-2 C.B. 1, the taxpayer elected to credit an overpayment shown on its [REDACTED] return to its [REDACTED] estimated tax liability but failed to designate the quarterly payment to which the overpayment was to be credited. The Service subsequently determined a deficiency for [REDACTED] and assessed interest on the deficiency from the due date of the first installment for [REDACTED] in accordance with Rev. Rul. 88-98. The taxpayer, however, had made estimated tax

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<sup>4</sup> The quarterly estimated tax payments due are per the fax dated [REDACTED], from the taxpayer's representative [REDACTED]. We have not verified the correctness of the estimated tax computation.

payments for the first and second quarters of [REDACTED] sufficient to avoid the addition to tax imposed by section 6655. The Court of Federal Claims held that the Government had had the use of taxpayer's overpayment from the due date of the first installment to the date taxpayer filed its [REDACTED] tax return since the overpayment was not needed to satisfy either the first or second estimated tax payments.

In light of May Department Stores, the Service has modified the manner in which it will compute interest on a deficiency for a year where the taxpayer elected to apply an overpayment shown on that year's return to the succeeding year's estimated taxes. Rev. Rul. 99-40, 1999-40 IRB 1 (September 16, 1999) provides that in such a case, the overpayment will be applied to the unpaid installments of estimated tax due on or after the date the overpayment arose in the order in which they are needed to avoid the imposition of an addition to tax for failure to pay estimated income tax under sections 6654 and 6655. Interest on the subsequently determined deficiency will then accrue from the date, and to the extent, the unapplied overpayment is no longer adequate to satisfy the deficiency. In determining when an overpayment is to be applied to estimated tax installment, any excess payments made for prior installments are to taken into account.

Rev. Rul. 99-40 does not address the issue of when interest begins to accrue on a deficiency where all or part of the overpayment is not needed to satisfy the succeeding year's estimated tax liability. It is the Service's position that in such a case, the overpayment should be treated as a payment of the succeeding year's income tax. Section 6513(d) provides:

If any overpayment of income tax is, in accordance with I.R.C. § 6402(b), claimed as a credit against estimated tax for the succeeding tax year, such amount shall be considered as a payment of the income tax for the succeeding taxable year (whether or not claimed as a credit in the return of estimated tax for such succeeding taxable year), and no claim for credit or refund of such overpayment shall be allowed for the taxable year in which the overpayment arises.

Under sections 6513(a) and 6151, the due date of the succeeding year's return is the last date on which an overpayment could be credited as a payment of the succeeding year's tax. Further, this is also the date the overpayment is treated as a payment for purposes of computing interest on any overpayment of income taxes with respect to the succeeding year under sections 6611(a) and (d). Accordingly, the statute requires that an overpayment which

the taxpayer elects to credit against the succeeding year's estimated tax must be treated as a payment against the succeeding year's tax liability no later than the due date of the succeeding year's return.

In the present case, the taxpayer's [REDACTED] overpayment would be applied as follows:

|  |    |   |
|--|----|---|
| Overpayment  | \$ |   |
| Applied to 1st Quarter Payment   |    | - |
| Unapplied Overpayment as of  |    |   |
| Applied to 2nd Quarter Payment   |    | - |
| Unapplied Overpayment as of  |    |   |
| Applied to 3rd Quarter Payment   |    | - |
| Unapplied Overpayment as of  |    |   |
| Applied to 4th Quarter Payment (\$ (required estimated tax payment) - (\$ (fourth quarter estimated tax payment) + \$ (excess first quarter payment) + \$ (excess second quarter payment) + \$ (excess third quarter payment)) |    |   |
| Unapplied Overpayment as of  |    | - |

Prior to the due date of the fourth quarterly installment for [REDACTED], no part of the [REDACTED] overpayment was required to be applied to the [REDACTED] estimated tax liability. At that time, however, the entire overpayment was needed to satisfy the [REDACTED] estimated tax liability. Accordingly, interest begins to accrue on that portion of the [REDACTED] deficiencies equal to the overpayment (\$[REDACTED]) as of [REDACTED], the due date of the fourth quarterly installment for [REDACTED]. (As to the excess of [REDACTED] deficiencies over the [REDACTED] overpayment, interest will continue to accrue from the original due date of the [REDACTED] return).

With respect to [REDACTED] and [REDACTED], no part of the overpayments for those years were required to be applied to the subsequent years' estimated tax liabilities as those liabilities were satisfied by the taxpayer's quarterly estimated tax payments (or, in some cases, by the quarterly estimated tax payment plus the

unused excess of prior quarterly installments). For [REDACTED], therefore, as the overpayment exceeded the deficiencies, no interest begins to accrue on the deficiencies until [REDACTED], the original due date of the [REDACTED] return. For [REDACTED], no interest begins to accrue on that portion of the deficiencies equal to the overpayment (\$ [REDACTED]) until [REDACTED], the original due date of the [REDACTED] return. (As to the excess of [REDACTED] deficiencies over the [REDACTED] overpayment, interest will continue to accrue from the original due date of the [REDACTED] return).

The taxpayer's [REDACTED] overpayment would be applied as follows:

|  |                  |
|--|------------------|
| [REDACTED] Overpayment   | \$ [REDACTED]    |
| Applied to 1st Quarter Payment   | <u>    -    </u> |
| Unapplied Overpayment as of [REDACTED]   | [REDACTED]       |
| Applied to 2nd Quarter Payment   | <u>    -    </u> |
| Unapplied Overpayment as of [REDACTED]   | [REDACTED]       |
| Applied to 3rd Quarter Payment (\$ [REDACTED]<br>(required estimated tax payment) -<br>(\$ [REDACTED] (third quarter estimated tax<br>payment) + \$ [REDACTED] (excess first quarter<br>payment) + \$ [REDACTED] (excess second quarter<br>payment) + \$ [REDACTED] shortfall) | [REDACTED]       |
| Unapplied Overpayment as of [REDACTED]   | <u>    -    </u> |
| Applied to 4th Quarter Payment   | <u>    -    </u> |
| Unapplied Overpayment as of [REDACTED]   | <u>    -    </u> |

Prior to the due date of the third quarterly installment for [REDACTED], no part of the [REDACTED] overpayment was required to be applied to the [REDACTED] estimated tax liability. At that time, however, the entire overpayment was required to be applied to the [REDACTED] estimated tax liability. Accordingly, interest begins to accrue on that portion of the [REDACTED] deficiencies equal to the overpayment (\$ [REDACTED]) as of [REDACTED], the due date of the third quarterly installment for [REDACTED]. (As to the excess of [REDACTED] deficiencies over the [REDACTED] overpayment, interest will continue to accrue from the original due date of the [REDACTED] return).

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If you have any questions respecting this matter, please call Jack Forsberg at (651) 290-3473, ext. 227.

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